

**BEFORE THE PUBLIC SERVICE COMMISSION
OF SOUTH CAROLINA**

**REBUTTAL TESTIMONY OF
STEVEN M. FETTER
ON BEHALF OF
DOMINION ENERGY SOUTH CAROLINA, INC.
DOCKET NO. 2020-125-E**

TABLE OF CONTENTS

I. INTRODUCTION	3
III. CREDIT RATINGS AND THEIR IMPORTANCE TO REGULATED UTILITIES.....	7
IV. FINANCIAL COMMUNITY PERCEPTIONS OF THE COMMISSION.....	16
V. REBUTTAL OF OPPOSING WITNESS TESTIMONY	19
A. Rebutting Recommendations to Artificially Alter The Company’s Actual Capital Structure of 53.35% Equity/ 46.65% Debt.....	19
B. Rebutting ORS Witness Kollen’s Recommendation that The Company’s Weighted Average Cost of Debt of 6.46% be Artificially Reduced.....	22
C. Rebutting DCA Witness Hempling’s Unsound Prudency Recommendations.....	23
VI. CONCLUSION.....	26

I. INTRODUCTION

Q. PLEASE STATE YOUR NAME, POSITION AND BUSINESS ADDRESS.

A. My name is Steven M. Fetter. I am President of Regulation UnFettered. My business address is 1240 West Sims Way, Port Townsend, Washington 98368.

Q. ON WHOSE BEHALF ARE YOU TESTIFYING?

A. I am providing rebuttal testimony on behalf of Dominion Energy South Carolina, Inc. ("DESC" or "the Company") before the Public Service Commission of South Carolina ("Commission").

Q. PLEASE DESCRIBE THE ISSUES UPON WHICH YOU ARE PROVIDING REBUTTAL TESTIMONY.

A. Utilizing my past experience as a state utility commission chairman and head of a major utility credit rating practice, my rebuttal testimony responds to the following witnesses, and their positions as noted:

- Aaron Rothschild, testifying on behalf of the South Carolina Department of Consumer Affairs, when he recommends a capital structure for DESC of 50% equity and 50% debt, noting its presence "at the low end" of the 50% to 55% range recommended by the Commission as part of the merger between Dominion and SCANA [direct testimony at 11];
- Dr. J. Randall Woolridge, testifying on behalf of the South Carolina Office of Regulatory Staff, when also he recommends a capital structure for DESC of 50% equity and 50% debt [direct testimony at 29];

- 1 • Dr. Zhen Zhu, testifying on behalf of the US Department of Defense (DOD), when he
2 recommends for DESC a capital structure of 52.56% equity and 47.44% debt, tracking
3 DESC's capital structure at test year end on December 31, 2019 [direct testimony at 28];
- 4 • Scott Hempling, Esq., testifying on behalf of the South Carolina Department of Consumer
5 Affairs (DCA), when he describes a regulatory paradigm that does not exist in South
6 Carolina, but, nonetheless, encourages the Commission to act upon the ideas for which he
7 advocates [direct testimony throughout]; and
- 8 • Lane Kollen, testifying on behalf of the South Carolina Office of Regulatory Staff (ORS),
9 when he calls for denial of 0.90% of the cost of long-term debt related to the early
10 redemptions of long-term debt following this Commission's approval of the Dominion
11 Energy – SCANA merger [direct testimony at 15].

12 **II. BACKGROUND**

13 **Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?**

14 A. I am President of Regulation UnFettered, a utility advisory firm I started in April 2002.
15 Prior to that, I was employed by Fitch, Inc. ("Fitch"), a credit rating agency based in New
16 York and London. Prior to that, I served as Chairman of the Michigan Public Service
17 Commission ("Michigan PSC"). I am also an attorney, having graduated from the
18 University of Michigan Law School in 1979.

19 **Q. PLEASE DESCRIBE YOUR SERVICE ON THE MICHIGAN PSC.**

20 A. I was appointed as a Commissioner to the three-member Michigan PSC in October 1987
21 by Democratic Governor James Blanchard. In January 1991, I was promoted to Chairman
22 by incoming Republican Governor John Engler, a designation that I retained following
23 reappointment in 1993. During my tenure as Chairman, timeliness of commission

1 processes was a major focus, and my colleagues and I achieved the goal of eliminating the
2 agency's case backlog for the first time in 23 years. While on the Michigan PSC, I also served
3 as Chairman of the Board of the National Regulatory Research Institute ("NRRI"), the research
4 arm of the National Association of Regulatory Utility Commissioners ("NARUC"). After leaving
5 regulatory service, I was appointed to the NRRI Board as a public member. I have also served as
6 a lecturer at Michigan State University's Institute of Public Utilities Annual Regulatory Studies
7 Program ("Camp NARUC") and at NARUC's New Commissioner Regulatory Orientation.

8 **Q. PLEASE DESCRIBE YOUR ROLE AS PRESIDENT OF REGULATION**
9 **UNFETTERED.**

10 A. I formed a utility advisory firm to use my financial, regulatory, legislative, and legal
11 expertise to aid the deliberations of regulators, legislative bodies, and the courts, and to
12 assist them in evaluating regulatory issues. My clients have included investor-owned and
13 municipal electric, natural gas and water utilities, state public utility commissions and
14 consumer advocates, non-utility energy suppliers, international financial services and
15 consulting firms, and investors.

16 **Q. WHAT WAS YOUR ROLE IN YOUR EMPLOYMENT BY FITCH?**

17 A. I was Group Head and Managing Director of the Global Power Group within Fitch. In that
18 role, I served as group manager of the combined 18-person New York and Chicago utility
19 team. I was originally hired to interpret the impact of regulatory and legislative
20 developments on utility credit ratings, a responsibility I continued to have throughout my
21 tenure at the rating agency. In April 2002, I left Fitch to start Regulation UnFettered.

1 **Q. HOW LONG WERE YOU EMPLOYED BY FITCH?**

2 A. I was employed by Fitch from October 1993 until April 2002. In addition, shortly after I
3 resigned to start Regulation UnFettered, Fitch retained me as a consultant for a period of
4 approximately six months.

5 **Q. HOW DOES YOUR EXPERIENCE RELATE TO YOUR TESTIMONY IN THIS**
6 **PROCEEDING?**

7 A. My experience as Chairman and Commissioner on the Michigan PSC and my subsequent
8 professional experience with financial analysis and ratings of the U.S. electric and natural gas
9 sectors – in jurisdictions involved in restructuring activity as well as those still following a
10 traditional regulated path – have given me solid insight into the importance of a regulator’s role
11 vis-à-vis regulated utilities, both in setting their rates as well as the appropriate terms and
12 conditions for the service they provide. In addition, for the past 20 years I have been a member
13 of the Wall Street Utility Group, an honorary society comprised of debt and equity analysts
14 assigned to cover and make assessments of companies within the utility sector.

15 **Q. HAVE YOU PREVIOUSLY GIVEN TESTIMONY BEFORE REGULATORY AND**
16 **LEGISLATIVE BODIES?**

17 A. Since 1990, I have testified before the U.S. Senate, the U.S. House of Representatives, the Federal
18 Energy Regulatory Commission, federal district and bankruptcy courts, and various state and
19 provincial legislative, judicial, and regulatory bodies in more than 100 proceedings or hearings on
20 the subjects of credit risk and cost of capital within the utility sector, electric and natural gas utility
21 restructuring, fuel and other energy cost adjustment mechanisms, regulated utility mergers and
22 acquisitions, construction work in progress and other interim rate recovery structures, utility
23 securitization bonds, and nuclear energy. I have previously testified and been accepted as an

1 expert witness before this Commission on behalf of Duke Energy Carolinas in Docket No.
2 2009-226-E. My full educational and professional background is presented in the attached
3 Exhibit No. ____ (SMF-1 Rebuttal).

4 **III. CREDIT RATINGS AND THEIR IMPORTANCE TO**
5 **REGULATED UTILITIES**

6 **Q. WHAT IS A CREDIT RATING AND WHY IS IT IMPORTANT?**

7 A. A credit rating reflects an independent judgment of the general creditworthiness of an obligor or
8 of a specific debt instrument. While credit ratings are important to both debt and equity investors
9 for a variety of reasons, their most important purpose is to communicate to investors the financial
10 strength of a company or the underlying credit quality of a particular debt security issued by that
11 company.

12 Credit rating determinations are made by rating agencies through a committee process involving
13 individuals with knowledge of a company, its industry, and its regulatory environment. Corporate
14 rating designations of S&P and Fitch have 'AAA,' 'AA,' 'A,' and 'BBB' category ratings within
15 the investment-grade ratings sphere, with 'BBB-' as the lowest investment-grade rating and
16 'BB+' as the highest non-investment-grade rating. Comparable rating designations of Moody's
17 at the investment-grade dividing line are 'Baa3' and 'Ba1,' respectively. In addition, the agencies
18 seek to make their rating judgments even more precise by dividing each of the rating categories
19 into three levels ('+', 'neutral,' and '-' at S&P and Fitch, and 1, 2 & 3 at Moody's). The following
20 chart illustrates the comparability of ratings among the three agencies.

CHART 1**Ratings Categories – Comparability Among Agencies**

Investment Grade	
<u>S&P and Fitch</u>	<u>Moody's</u>
AAA	Aaa
AA+	Aa1
AA	Aa2
AA-	Aa3
A+	A1
A	A2
A-	A3
BBB+ ⁽¹⁾	Baa1
BBB	Baa2 ⁽²⁾
BBB-	Baa3

Below Investment Grade	
<u>S&P and Fitch</u>	<u>Moody's</u>
BB+	Ba1
BB	Ba2
BB-	Ba3
B+	B1
B	B2
B-	B3
CCC	Caa
CC	Ca
C	C
D	[C]

- 1 Corporate credit rating analysis considers both qualitative and quantitative factors to assess the
2 financial and business risks of fixed-income debt issuers. A credit rating is an indication of an
3 issuer's ability to service its debt, both principal and interest, on a timely basis. It also at times
4 incorporates some consideration of ultimate recovery of investment in case of default or

¹ S&P and Fitch issuer ratings of DESC are BBB+, S&P with a Positive outlook and Fitch with a Stable outlook.

² Moody's issuer rating of DESC is Baa2 with a Stable outlook.

1 insolvency. Ratings can also be used by contractual counterparties to gauge both the short-term
 2 and longer-term financial health and viability of a company, including decisions related to
 3 required collateral levels, with higher-rated entities facing lower requirements.

4 **Q. HOW WOULD YOU DESCRIBE DESC'S CREDIT RATINGS STATUS?**

5 A. DESC's corporate issuer credit ratings span between the top level of the BBB category
 6 (BBB+ at S&P [Positive outlook] and Fitch [Stable outlook]) to the middle of the BBB
 7 category (Baa2 at Moody's with a Stable outlook).³ I have long testified that a regulated
 8 utility should endeavor to hold ratings no lower than 'Baa1 / BBB+', with a longer-term
 9 goal of moving into (or maintaining in) the 'A' category. Accordingly, I encourage both
 10 the Commission and the Company to seek to achieve BBB+ / Baa1 credit ratings across
 11 the board at all three agencies after this proceeding has concluded.

12 **Q. WHY ARE CREDIT RATINGS IMPORTANT FOR REGULATED UTILITIES**
 13 **AND THEIR CUSTOMERS?**

14 A. A utility's credit ratings have a significant impact on its ability to raise capital on a timely
 15 basis and upon reasonable terms. As economist Charles F. Phillips states in his highly-
 16 respected treatise on utility regulation:

17 Bond ratings are important for at least four reasons: (1) they are used by
 18 investors in determining the quality of debt investment; (2) they are used in
 19 determining the breadth of the market, since some large institutional
 20 investors are prohibited from investing in the lower grades; (3) they
 21 determine, in part, the cost of new debt, since both the interest charges on
 22 new debt and the degree of difficulty in marketing new issues tend to rise

³ Corporate or issuer utility credit ratings reflect the intrinsic financial strength of the utility being rated, with no backing from or recourse against specific utility assets. At times, regulated utilities issue secured debt, representing utility borrowings that are backed by collateral, usually in the form of utility real property. In virtually all cases, secured credit ratings are higher than corporate/issuer credit ratings because, in the case of a utility defaulting on its bond payment obligations, secured debtholders have recovery priority on the defined collateral as compared to the claims of unsecured debtholders.

1 as the rating decreases; and (4) they have an indirect bearing on the status
 2 of a utility's stock and on its acceptance in the market.⁴
 3

4 Thus, a utility with strong credit ratings is not only able to access the capital markets on a
 5 timely basis at reasonable rates, it is also able to share the benefit from those attractive
 6 interest rate levels with customers since cost of capital gets factored into utility rates.
 7 Conversely, but of equal importance, the lower a utility's credit rating, the more the utility
 8 must pay to raise funds from debt and equity investors, and those higher capital costs get
 9 factored into the rates that consumers are required to pay. Electric utilities like DESC are
 10 among the most capital-intensive industries.

11 **Q. IS THERE A RELATIONSHIP BETWEEN A REGULATED UTILITY'S**
 12 **CAPITAL STRUCTURE AND ITS CREDIT RATINGS?**

13 A. Yes. As I discuss more fully below, a higher debt level negatively affects a regulated utility's
 14 credit profile, which in turn can impact that utility's credit ratings and cost of capital.

15 **Q. WHY DO YOU RECOMMEND RATINGS NO LOWER THAN Baa1/BBB+ FOR**
 16 **A REGULATED ELECTRIC UTILITY?**

17 A. For the reasons stated in my previous answer, regulatory support for a BBB+ / Baa1 credit
 18 profile (or higher) for DESC is especially important in view of its need to access substantial
 19 amounts of debt and equity, on a near daily basis, to fund its ongoing operations, including capital
 20 investments. This of course includes capital investment related to day-to-day maintenance and
 21 infrastructure enhancement related to its ongoing duty to serve customers in a safe and reliable
 22 manner. Significantly, a regulated utility is required to raise funding even if the markets are in

⁴ Phillips, Charles F., Jr., The Regulation of Public Utilities, 250 (3rd Ed. 1993) (Emphasis supplied). *See also* Public Utilities Reports Guide: "Finance," Public Utilities Reports, Inc., 6-7 (2004) ("Generally, the higher the rating of the bond, the better the access to capital markets and the lower the interest to be paid.").

1 turmoil and costs are escalating wildly. Strong credit ratings limit the negative effects of having
2 to finance during times of great volatility within the capital markets, as was seen back during the
3 2008-2009 recession when ‘BBB’-rated utilities were subject to significantly higher interest rates
4 than ‘A’-rated utilities, along with more restricted access, if available at all, along with stricter
5 financing terms.

6 **Q. WHAT QUALITATIVE FACTORS ARE USED BY THE RATING AGENCIES TO**
7 **ESTABLISH UTILITY CREDIT RATINGS?**

8 A. The most important qualitative factors are regulation, management and business strategy,
9 and access to energy, gas and fuel supply with timely recovery of associated costs.

10 **Q. WHAT ARE THE KEY QUANTITATIVE MEASURES?**

11 A. The major rating agencies use several financial measures within their utility financial
12 analysis. S&P currently highlights the following two core financial ratios as its key
13 indicators: Funds from Operations to Debt (FFO / Debt), which focuses on cash flow; and
14 Debt to Earnings Before Interest, Taxes, Depreciation and Amortization (Debt / EBITDA),
15 which provides a comparative profitability measure.⁵ A focus on these two ratios is
16 consistent with S&P’s long-held belief that “Cash flow analysis is the single most critical
17 aspect of all credit rating decisions.”⁶

18 **Q. WHY IS REGULATION A KEY QUALITATIVE COMPONENT OF THE**
19 **UTILITY CREDIT RATING PROCESS?**

⁵ S&P Research: “Corporate Methodology,” November 19, 2013 (republished with nonmaterial changes December 7, 2018).

⁶ S&P Research: “A Closer Look at Ratings Methodology,” November 13, 2006.

1 A. Regulation is a key factor in assessing the financial strength of a utility because, unlike for
2 almost all other entities obtaining financing in the marketplace, a state public utility
3 commission determines revenue levels (recoverable expenses including depreciation and
4 operations and maintenance, fuel cost recovery, and return on investment) and the terms
5 and conditions of service that affect a utility's cost of service. As Moody's has noted, "A
6 utility's ability to recover its costs and earn an adequate return are among the most
7 important analytical considerations when assessing utility credit quality and assigning
8 credit ratings."⁷

9 The quality and direction of regulation play a key role in shaping investors' expectations
10 of how these factors may change in the future. With the era of restructuring now in its third
11 decade, regulation has had to evolve as the nature of a utility's responsibilities in providing
12 energy services to customers has undergone dramatic change.

13 The regulatory environment affects utility investors' decisions because, before they are
14 willing to put forward substantial sums of money, they must assess the degree to which
15 regulators understand and accommodate the economic requirements and the financial and
16 operational risks of a rapidly changing industry. Utility investors understand and accept
17 the role of extensive regulation, but they seek from the regulatory process decision-making
18 that is fair, with a significant degree of predictability.

19 For these reasons, rating agencies look for the consistent application of sound economic
20 and regulatory principles by utility regulators. If a regulatory body were to encourage a

⁷ Moody's Research: "Cost Recovery Provisions Key to Investor Owned Utility Ratings and Credit Quality: Evaluating a Utility's Ability to Recover Costs and Earn Returns," June 18, 2010.

1 utility to make investments based upon an expectation of the opportunity to earn a
 2 reasonable return, and then did not apply regulatory principles in a manner consistent with
 3 those expectations, investor interest in providing funds to the utility would decline, debt
 4 ratings would likely suffer, and the utility's cost of capital would increase, to the detriment
 5 of ratepayers.

6 **Q. AT THE CORE OF SUCH REGULATORY REVIEW IS THE CONCEPT OF**
 7 **PRUDENCY. WOULD YOU EXPLAIN "PRUDENCY" WITHIN THE CONTEXT**
 8 **OF UTILITY REGULATION?**

9 A. The concept of "prudency" is present in the legislative and/or administrative rules of every
 10 utility commission across the U.S. In their reference book Fundamentals of Energy
 11 Regulation, authors (and Ph.D. economists) Lesser & Giacchino discuss prudence both in
 12 terms of the deference accorded utility management decisions, as well as the review
 13 process before imprudent behavior is found to have occurred:

14 "...utility management is given the benefit of the doubt, and
 15 management's decisions are presumed reasonable unless the facts
 16 show otherwise. ...Moreover, the prudence of managerial decisions
 17 must be judged on their reasonableness at the time those decisions
 18 were made and based on information then available. Prudence is not
 19 meant as an exercise in hindsight regulation. In essence, a prudent
 20 decision is one that a reasonable person could have made in good
 21 faith, given the information and decision tools available at the time
 22 of the decision."⁸

23 In support of that position, economist Charles F. Phillips in his utility regulation treatise
 24 referenced above quotes the views of the Massachusetts and New York commissions:

25 "A prudence review must determine whether the company's actions, based
 26 on all that it knew or should have known at the time were reasonable and
 27 prudent in light of the circumstances which then existed. It is clear that such

⁸ Jonathan A. Lesser & Leonardo R. Giacchino, Fundamentals of Energy Regulation, 42 (1st Ed. 2007).

1 a determination may not properly be made on the basis of hindsight
 2 judgments, nor is it appropriate for the [commission] merely to substitute
 3 its best judgment for the judgments made by the company's managers." [*In*
 4 *re Western Mass. Elec. Co.*, 80 PUR4th at 501.]

5 "The company's conduct should be judged by asking whether the conduct was
 6 reasonable at the time, under all the circumstances, considering that the company
 7 had to solve its problems prospectively rather than in reliance on hindsight. In
 8 effect, our responsibility is to determine how reasonable people would have
 9 performed the task that confronted the company." [*In re Consolidated Edison Co.*
 10 *of N.Y. Inc.*, Opinion No. 79-1 (N.Y. 1979), 5-6.]⁹

11 **Q. OTHER ASPECTS OF UTILITY REGULATION THAT YOU HAVE OFTEN**
 12 **TESTIFIED ABOUT ARE THE "REGULATORY COMPACT" AND ALSO**
 13 **"CONSTRUCTIVE UTILITY REGULATION." COULD YOU PROVIDE A**
 14 **DESCRIPTION OF WHAT THESE KEY CONCEPTS ENTAIL?**

15 A. There is an unwritten but core concept within the regulatory process known as the "regulatory
 16 compact." Since there is no hard and fast universal rule or regulation delineating the "regulatory
 17 compact," it has been described in many different ways. In the above-noted reference book, Lesser
 18 & Giacchino describe that under the "regulatory compact:"

19 ... the regulator grants the company a protected monopoly, essentially a franchise,
 20 for the sale and distribution of electricity or natural gas to customers in its defined
 21 service territory. In return, the company commits to supply the full quantities
 22 demanded by those customers at a price calculated to cover all operating costs
 23 plus a "reasonable" return on the capital invested in the enterprise. The first half
 24 of this "compact" protects the company from would-be competitors and secures
 25 for the public the substantial economies of scale available in the large-scale
 26 production of electricity. The second half of the "compact" counteracts the
 27 injurious tendency of monopolies to raise prices above the level that would prevail
 28 in a competitive market.¹⁰

⁹ Phillips, The Regulation of Public Utilities, 340-341.

¹⁰ Lesser & Giacchino, Fundamentals of Energy Regulation, 43-44.

1 In my experience advising a range of utility industry stakeholders across the U.S., I have found
2 that every utility commission adheres to some conception of the “regulatory compact” in concert
3 with the constitutionally-and-statutorily-mandated prudence standards.

4 In addition, my own conception of “constructive utility regulation” is that which aligns the
5 seemingly competitive interests of utility investors and utility customers in a manner that is
6 consistent and steady over time, so that all parties have reasonable expectations about how
7 regulatory policy will be effectuated. Importantly, it supports a utility’s ability to provide safe and
8 clean utility service to its customers with a high level of reliability at reasonable rates. Constructive
9 regulation is efficient and predictable with a long-term focus on stable rates, while also
10 recognizing the need for timely recovery of costs and the value to customers of a financially-strong
11 utility with ready access to the capital markets at attractive rates, even when the financial markets
12 are under stress. It recognizes that utility investors react negatively to major, frequent or sudden
13 changes in regulatory policy and that such uncertainty ultimately has an adverse effect on
14 customers. In sum, longstanding constructive regulatory policy should provide a utility with the
15 confidence to make capital-intensive investments and incur O&M expenses for the benefit of its
16 customers, with the reasonable expectation that those costs would be recovered in a timely
17 manner, including a fair return on investment, consistent with that stable and consistent regulatory
18 policy.

19 **Q. HAVE THE RATING AGENCIES DISCUSSED THE IMPORTANCE OF**
20 **“CONSTRUCTIVE REGULATION” IN THEIR ASSESSMENT OF UTILITY**
21 **CREDIT PROFILES?**

22 **A.** Yes, I saw firsthand how important constructive regulation is to agencies when Fitch
23 recruited me to provide regulatory analysis after I had decided to move on from the

Michigan PSC. Moody's has highlighted the critical role that regulators play in a June 23, 2017 report entitled "Rating Methodology: Regulated Electric and Gas Utilities:"

An over-arching consideration for regulated utilities is the regulatory environment in which they operate. While regulation is also a key consideration for networks, a utility's regulatory environment is in comparison often more dynamic and more subject to political intervention. The direct relationship that a regulated utility has with the retail customer ... can lead to a more politically charged rate-setting environment. ...Our views of regulatory environments evolve over time in accordance with our observations of regulatory, political, and judicial events that affect issuers in the sector.¹¹

And S&P has long held the same view:

Regulatory advantage is the most heavily weighted factor in [S&P's] analysis of a regulated utility's business risk profile. ...An established, dependable approach to regulating utilities is a hallmark of a credit-supportive jurisdiction. ...Major or frequent changes to the regulatory model invariably raise risk due to the possibility of future changes. Steady application of transparent, comprehensible policies and practices lowers risk. ...We adjust the assessment downward if the development of the framework was contentious due to policy disputes or legal actions, indicating that the political consensus regarding utility regulation is fragile. ... [A] regulatory approach that allows utilities the opportunity to consistently earn a reasonable return as a positive credit factor in our regulatory assessments. ...We measure the timeliness of rate decisions, the obsolescence of the costs on which the rates are based, the timing of interim rates, and other practices (such as allowing rates to automatically change in a future period based on inflation) that affect a utility's ability to earn its authorized return. ...Practices such as legislative or regulatory recognition of the need for preapproval of [large capital projects], periodic reviews that substantively involve the regulator in the progress of the project, and rolling prudence determinations during construction can reduce the general level of risk. ...[W]e consider financial stability to be of substantial importance [with cash taking] precedence in credit analysis. ...We assess a jurisdiction most strongly if all large expense items are recoverable through an automatic tariff clause that is based on projected costs, adjusts frequently, and has no record of any significant disallowances. ... [A] primary factor ... is the political independence of regulators.¹²

IV. FINANCIAL COMMUNITY PERCEPTIONS OF THE COMMISSION

Q. HOW IS THE COMMISSION VIEWED BY THE FINANCIAL COMMUNITY?

¹¹ Moody's Research: "Rating Methodology: Regulated Electric and Gas Utilities," June 23, 2017.

¹² S&P Research: "Assessing U.S. Investor-Owned Utility Regulatory Environments," January 7, 2014.

1 A. The financial community's view of the Public Service Commission of South Carolina has
2 been relatively balanced, though the complexity of regulating during the lead up to
3 abandonment of two nuclear plants during construction did stress investor views of the
4 Commission. Probably the most objective and respected commentator on regulatory policy
5 and activities from a financial community perspective is Regulatory Research Associates
6 ("RRA"). RRA currently rates the South Carolina regulatory environment (which goes
7 beyond the Commission to also include legislative and executive branch policies) as
8 Average 3,¹³ placing the Commission at approximately the 75th percentile of the 53
9 regulatory jurisdictions upon which RRA currently opines. This lower ranking of the
10 state's regulatory climate can stress the Company's ratings when they are reviewed within
11 the credit rating analytical process, though I expect that the Commission decision in this
12 important case, coming as it will post-nuclear plants abandonment and post-merger, could
13 very well affect RRA's future assessment of the South Carolina regulatory environment.

14 **Q. DO THE RATING AGENCIES SHARE RRA'S ASSESSMENT OF THE SOUTH**
15 **CAROLINA REGULATORY ENVIRONMENT?**

16 A. I would say that the views of the three agencies are somewhat mixed, but they all agree on
17 the importance of the decision in this case. Interestingly, Moody's, which maintains the
18 lowest credit rating on DESC, sees an improving direction in the state, noting that for parent
19 Dominion Energy, "...low regulatory risk persists across its utility businesses, including

¹³ RRA's commission ranking scale has 9 tiers: Above Average 1, 2 & 3; Average 1, 2 & 3; and Below Average 1, 2 & 3.

1 an improvement to the predictability of the South Carolina political and regulatory
2 environment.”¹⁴

3 S&P, which rates DESC one notch higher than Moody’s (with a Positive outlook added
4 on), cautions about DESC’s “less credit supportive regulatory environment in South
5 Carolina,” and warns that lower ratings could occur “if management of regulatory risk in
6 South Carolina does not consistently improve.” But at the same time, S&P offers the
7 encouraging words that DESC’s ratings could go up if the Company is able to “improve its
8 regulatory relationship and outcomes” in the state.¹⁵

9 Fitch also maintains an issuer rating on DESC of BBB+, but with a Stable outlook. Fitch
10 agrees with S&P and Moody’s that, “A favorable outcome in [this rate case] may result in
11 additional rating improvement for DESC in 2021.” The agency further notes that negative
12 rating action could follow upon “unfavorable state regulatory or legislative developments.”
13 Importantly, the key assumptions Fitch has factored into its current BBB+ [Stable] rating
14 are “maintenance of DESC’s capital structure in line with regulatory capital structure,” and
15 a constructive 2021 base rate decision.¹⁶

¹⁴ Moody’s Research: “Dominion Energy, Inc.,” July 14, 2020.

¹⁵ S&P Research: “Dominion Energy Inc. and Subsidiaries Outlooks Revised to Positive on Planned Asset Sale and Cancelled Pipeline Project,” July 7, 2020.

¹⁶ Fitch Research, “Dominion Energy South Carolina, Inc.,” September 23, 2020.

V. REBUTTAL OF OPPOSING WITNESS TESTIMONY

A. Rebutting Recommendations to Artificially Alter The Company's Actual Capital Structure of 53.35% Equity/ 46.65% Debt

Q. TWO OPPOSING WITNESSES HAVE RECOMMENDED CAPITAL STRUCTURES WITH A 50% - 50% EQUITY/DEBT SPLIT, WITH ANOTHER WITNESS SOMEWHAT HIGHER AT 52.56% EQUITY AND 47.44% DEBT. CAN YOU EXPLAIN HOW YOUR REGULATORY AND CREDIT RATING AGENCY LEADERSHIP EXPERIENCE AFFECTS YOUR VIEW OF THE APPROPRIATENESS OF THOSE PROPOSED CAPITAL STRUCTURES?

A. Yes I can. My regulatory and credit rating agency leadership experience informs my view of the Company's ratings as improving, but not yet at the minimum level I recommend for US regulated utilities, which is BBB+ /Baa1.

Q. HOW DID YOU ORIGINALLY COME TO THAT CONCLUSION?

A. I set the lower end of my recommendation at BBB+ during the 1990's, back when I was serving as head of the utility ratings practice at Fitch. I did so because I believed that that level provided a regulated utility with substantial protection related to financing in the case of a major downturn in the economy or unrest in the capital markets. Thereafter, we all witnessed two regulated utilities that faced unforeseen, unavoidable, and virtually unimaginable catastrophes – the September 11 terrorist attack in New York City, and Hurricane Katrina in New Orleans. Those horrific events led me to add the longer term goal of achieving or maintaining ratings in the A category, a level at which I cannot imagine that funding would ever be restricted in the face of severe financial or operational duress.

Q. PLEASE EXPLAIN.

1 A. On September 11, 2001, Consolidated Edison of New York (“Con Ed”) held two “A” category
2 ratings. In the face of the terrible events of that day, Con Ed was able immediately to initiate one
3 of the largest infrastructure recovery efforts any industry has ever faced, without seeking special
4 treatment from lenders or suppliers. Contrast that with Entergy New Orleans (“ENO”), whose
5 credit profile had been on an improving track from BBB with a Credit Watch Negative to a BBB
6 with a Stable outlook. Then in August 2005, Hurricane Katrina devastated the utility’s
7 infrastructure and customer base. Amidst that tragedy, the utility faced resistance from its
8 contractual counterparties to provide supplies and assistance. ENO soon filed for bankruptcy,
9 paving the way for parent Entergy Corporation to provide \$200 million in funds to support the
10 long process of reorganization and recovery. I acknowledge that, in this case, my
11 recommendations do not target the longer term goal of A-category ratings for DESC. Rather, first
12 things first: my position supports achieving and solidifying the Company’s ratings at the BBB+ /
13 Baa1 level.

14 **Q. CAN YOU DISCUSS HOW THE COMPANY’S PROPOSED CAPITAL STRUCTURE**
15 **FOR RATEMAKING WOULD AFFECT THE BBB+ / Baa1 GOAL THAT YOU**
16 **SUPPORT?**

17 A. Yes. While serving first as a commissioner and later as chairman of the Michigan PSC, I gave
18 deference to utility managerial decision-making if their actions proved to be both prudent and
19 within a reasonable range of behavior. I continue to believe that this is an important factor in
20 regulation and one that remains true to the regulatory compact. In her direct testimony, Company
21 witness Iris Griffin recommends an authorized capital structure of 53.35% equity and 46.65%
22 debt, based upon actual levels as of May 30, 2020. This recommendation is slightly above the
23 levels that are baked into the Company’s current rates: 52.18% equity dating back to the

1 predecessor utility's last rate case in 2012, as supplemented by a decision of this Commission in
2 January 2019 that \$2.8 billion in additional nuclear rate base would be set based upon a 52.81%
3 equity component. That is the financial data that underlies DESC's improving ratings. I note,
4 however, that while the rating agencies are regularly briefed by issuers as to evolving and
5 forecasted financial measures – such as the actual capital structure data presented by Ms. Griffin
6 here, normal practice would be for the agencies to await the final regulatory determination on the
7 issues before factoring them into updated ratings. This is especially so if the Commission were to
8 reject the higher equity level, because the expectation would be that the Company would modify
9 its equity and debt to match the capital structure that is authorized for ratemaking. In any event,
10 the proposals of the two opposing witnesses that have recommended 50-50 equity/debt levels
11 would weaken the Company's overall credit profile, and opposing DOD witness Dr. Zhen's
12 proposed capital structure of 52.56% - 47.44% equity/debt largely tracks current rate components
13 that, while providing support for the current mid-to-high BBB-category ratings, still result in
14 ratings an important and challenging notch below my minimum target level.

15 **Q. PLEASE SUMMARIZE YOUR VIEWS WITH RESPECT TO THE COMPANY'S**
16 **PROPOSED CAPITAL STRUCTURE.**

17 A. I believe the Company's proposed capital structure at 53.35% - 46.65% equity/debt, 79 basis
18 points above Dr. Zhen's recommendation, is deserving of Commission support in that it is based
19 upon current actual data; Company maintenance of that level would be consistent with rating
20 agency assumptions as recently noted by Fitch; and such increment in equity level should allow
21 for continued improvement in the Company's credit profile, with a goal of the Moody's rating
22 joining S&P and Fitch at the BBB+ / Baa1 level.

1 **B. Rebutting ORS Witness Kollen's Recommendation that The Company's Weighted**
2 **Average Cost of Debt of 6.46% be Artificially Reduced**

3 **Q. FINALLY, YOU REFERENCE THAT YOU DISAGREE WITH OPPOSING WITNESS**
4 **KOLLEN'S CALL FOR DENIAL OF 0.90% OF THE COMPANY'S COST OF LONG-**
5 **TERM DEBT. PLEASE EXPLAIN.**

6 A. Yes, but first let me state that I defer to Company witness Griffin with regard to commitments
7 made within the merger proceeding, and the impact of any FERC rules on the events or
8 transactions that occurred during the merger review and after regulatory approval. I am offering
9 my view of the import of the early redemptions of long-term debt vis-à-vis capital structure and
10 credit ratings, both of which the Commission stated should be targeted for improvement following
11 its approval of the merger.

12 **Q. AND YOU HAVE ALREADY INDICATED THAT BOTH THE EQUITY**
13 **COMPONENT IN DESC'S CAPITAL STRUCTURE AND ITS CREDIT RATINGS**
14 **HAVE IMPROVED AS COMPARED PRE-AND-POST MERGER. IS THAT RIGHT?**

15 A. Yes, it is. As noted by both Mr. Kollen and Ms. Griffin, financial advisors were utilized to assist
16 with the early redemptions of debt that successfully brought the equity component of the capital
17 structure from 45.11% up to its current 53.35%. Not surprisingly with that kind of equity
18 enhancement, DESC's credit ratings have improved at all three agencies up to its current levels in
19 the Baa2 to BBB+ range, but not yet up to what I believe to be the level of credit ratings that a
20 utility should attain based upon its effective managerial operations and sustained constructive
21 regulatory support. I further note that Commission rejection of the Company's actual cost of
22 long-term debt would not help DESC to achieve that appropriate level.

1 **Q. MR. KOLLEN SEEMS TO IMPLY THAT THE COMPANY PICKED AND CHOSE**
2 **DEBT REDEMPTIONS TO DRIVE UP ITS OVERALL COST OF LONG-TERM**
3 **DEBT. WOULD YOU AGREE WITH HIS ASSESSMENT?**

4 A. No I do not. From my experience as head of Fitch utility ratings, I know that every debt instrument
5 has its own terms and conditions that would affect the ease or difficulty of its early redemption
6 and the potential cost or penalty of such action. It is simply not in the interests of either the
7 Company or its financial advisors to try to game the system as it carried out the process of retiring
8 the excess of long-term debt, with the aim of improving the Company's credit profile and financial
9 stability. I therefore am of the informed view that the debt retirements that occurred were
10 prudently managed by the Company and its advisors, as reported by Company Witness Griffin in
11 her rebuttal testimony, and that the debt remaining on the Company's balance sheet is reasonable
12 and necessary and should be approved for ratemaking purposes at its weighted average cost.

13 **C. Rebutting DCA Witness Hempling's Unsound Prudency Recommendations**

14 **Q. TURNING TO MR. HEMPLING'S DIRECT TESTIMONY, WOULD YOU DISCUSS**
15 **YOUR VIEWS ABOUT THE CONCEPTS HE ESPOUSES?**

16 A. Yes, I will, but first in the interest of full disclosure, let me discuss my 30+ years of interaction
17 with Mr. Hempling. My first connection with him came during my six years on the Michigan
18 PSC, during which time, we sometimes retained him to represent the commission's positions
19 before the Federal Energy Regulatory Commission. Later on, I served on the National Regulatory
20 Research Institute Board of Directors, and my tenure overlapped with the Institute hiring Mr.
21 Hempling to be its Executive Director and providing him with Board guidance related to strategic
22 direction for the organization. Since that time, I have on occasion filed testimony in opposition to
23 his testimony in regulatory cases, as I will proceed to do here.

1 With regard to his views in this case, I think Mr. Hempling sums it up best when he states (at 16),
2 “The presumption of prudence currently imposes on South Carolina’s captive utility customers
3 the burden of showing their monopoly utility’s imprudence.” Thus, Mr. Hempling’s claim (at 16)
4 that “DESC has presented no evidence that its \$2.3 billion cost is a prudent cost” seems to call for
5 review of costs previously a part of past Commission proceedings, and is irrelevant under his self-
6 admitted sequence and process underlying prudency reviews. I have fully described the concept
7 of prudence earlier in this testimony, and I see no violation by the Company of its obligations
8 under that regulatory framework.

9 **Q. YOU HAVE DETAILED THE UNDERPINNINGS OF PRUDENCY IN THIS**
10 **TESTIMONY. CAN YOU JUST REVIEW SOME OF THE CONCEPTS THAT ARE**
11 **AT ODDS WITH WHAT MR. HEMPLING HAS ARGUED?**

12 A. First off, as noted above by Lesser and Giacchino, the principle that prudently-incurred costs
13 should be recovered in rates is fundamental to the regulatory compact that undergirds investor
14 willingness to provide needed funding for public utilities in exchange for a fair return on their
15 investment. The following quote from their above-referenced Fundamentals of Utility Regulation
16 (at 39) expands upon this principle:

17 No firm can operate as a charity and withstand the rigors of the
18 marketplace. To survive, any firm must take in sufficient
19 revenues from customers to pay its bills and provide its
20 investors with a reasonable expectation of profit....Regulated
21 firms are no exception. They face the same constraints....

22 A basic concept underlying all forms of economic regulation
23 is that a regulated firm must have the opportunity to recover
24 its costs.... Without the opportunity to recover all of its costs
25 and earn a reasonable return, no regulated private company
26 can attract the capital necessary to operate.

1 Such prudent cost recoverability is a key aspect of the business relationship between investors
2 (those with the funds) and regulated utilities (those who require those funds). For almost 40 years,
3 initially as a gubernatorial and legislative counsel, later as a utility chairman and commissioner,
4 and more recently as a consultant to regulated utilities, utility commissions and consumer
5 advocates, I have been involved with the concept of prudence. In everyday language, I view a
6 prudent decision as one that is made by a person with skills appropriate for the subject matter that
7 falls within a range of reasonable results based upon the circumstances that exist at the time the
8 decision is made. Contrary to Mr. Hempling's claim (at 7) that DESC's costs must represent "the
9 least-cost means of carrying out [its] actions," management judgment does not need to be a perfect
10 decision or one that ultimately turns out to be correct. There can be more than one prudent
11 alternative.

12 **Q. WHAT DO YOU BELIEVE WOULD BE THE LIKELY REACTION FROM THE**
13 **FINANCIAL COMMUNITY IF MR. HEMPLING'S CONCEPTS WERE TO BE**
14 **ADOPTED BY THE COMMISSION?**

15 **A.** Stark movement away from traditional ratemaking principles, most especially the well-established
16 prudence standard including the validity of regulatory determinations made in prior cases, would
17 not be received well by either the credit rating agencies or equity and debt investors. Investors
18 deciding where their funds should flow will take into consideration the increased level of risk that
19 would accompany adoption of a new regulatory paradigm -- one that sidesteps the prudence
20 challenge requirement and allows for disallowances based upon speculation and concerns about
21 cost levels and previously-reviewed expenditures. Such a policy would certainly increase the
22 costs of both equity and debt capital, an impact that ultimately lands at the doorstep of the customer
23 in the form of higher rates.

1 **Q. ACCORDINGLY, DO YOU SEE A PLACE FOR MR. HEMPLING'S ARGUMENTS**
2 **WITHIN THE CONTEXT OF THIS PROCEEDING?**

3 A. I do not, and in my view those arguments should be rejected in this case because they are
4 inconsistent with existing prudence standards as Mr. Hempling candidly admits. Moreover, if
5 Mr. Hempling and his client were to succeed at getting the ideas he has expressed in this testimony
6 enacted into law within South Carolina, the interests of the financial community to fund utility
7 operations and ensure reliability for customers would no longer be directed toward the regulated
8 utilities within this state. And in my opinion that would be most adverse to, and against the
9 financial interests of, the very consumers for whom Mr. Hempling and his client advocate.

10 **VI. CONCLUSION**

11 **Q. DO YOU HAVE CONCLUDING THOUGHTS?**

12 A. Yes. As I have testified to utility commissions across the U.S., I believe that utilities and their
13 regulators should strive to attain corporate / issuer credit ratings no lower than BBB+ / Baa1, with
14 a longer-range strategy to achieve ratings within the A category. Accordingly, I encourage the
15 Commission to provide an ongoing constructive regulatory environment for DESC. Such positive
16 regulatory environment, coupled with DESC providing excellent operational performance, should
17 allow the Company to strengthen its credit profile after conclusion of this proceeding.
18 Furthermore, notwithstanding my considerable respect for Mr. Hempling as a strong proponent
19 for consumer interests, I believe that this case should be decided upon the laws, rules and
20 regulations as they exist in South Carolina today, and not upon ideas that, if adopted, would surely
21 result in the Company's cost of capital being substantially increased, if such capital would even
22 remain available within such a changed regulatory environment.

1 **Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?**

2 A. Yes, it does.

STEVEN M. FETTER

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Education University of Michigan Law School, J.D. 1979
Bar Memberships: U.S. Supreme Court, New York, Michigan
University of Michigan, A.B. Media (Communications) 1974

April 2002 – Present

President - Regulation UnFettered -- Port Townsend, Washington

Founder of advisory firm providing regulatory, legislative, financial, legal and strategic planning advisory services for the energy, water and telecommunications sectors, including public utility commissions and consumer advocates; federal and state testimony; credit rating advisory services; negotiation, arbitration and mediation services; skills training in ethics, negotiation, and management efficiency.

Service on Boards of Directors of: Central Hudson (Fortis Inc. subsidiary) (Chairman, Governance and Human Resources Committee); and Previously CH Energy Group (Lead Independent Director; Chairman, Audit Committee, Compensation Committee, and Governance and Nominating Committee); National Regulatory Research Institute (Chairman); Keystone Energy Board; and Regulatory Information Technology Consortium; Member, Wall Street Utility Group; Participant, Keystone Center Dialogues on RTOs and on Financial Trading and Energy Markets.

October 1993 – April 2002

Group Head and Managing Director; Senior Director -- Global Power Group, Fitch IBCA Duff & Phelps -- New York / Chicago

Manager of 18-employee (\$15 million revenue) group responsible for credit research and rating of fixed income securities of U.S. and foreign electric and natural gas companies and project finance; Member, Fitch Utility Securitization Team.

Led an effort to restructure the global power group that in three years' time resulted in 75% new personnel and over 100% increase in revenues, transforming a group operating at a substantial deficit into a team-oriented profit center through a combination of revenue growth and expense reduction.

Achieved national recognition as a speaker and commentator evaluating the effects of regulatory developments on the financial condition of the utility sector and individual companies; Cited by Institutional Investor (9/97) as one of top utility analysts at rating agencies; Frequently quoted in national newspapers and trade publications including The New York Times, The Wall Street Journal, International Herald Tribune, Los Angeles Times, Atlanta Journal-Constitution, Forbes and Energy Daily; Featured speaker at conferences sponsored by Edison Electric Institute, Nuclear Energy Institute, American Gas Assn., Natural

Gas Supply Assn., National Assn. of Regulatory Utility Commissioners (NARUC), Canadian Electricity Assn.; Frequent invitations to testify before U.S. Senate (on C-Span) and House of Representatives, and state legislatures and utility commissions.

Participant, Keystone Center Dialogue on Regional Transmission Organizations; Member, International Advisory Council, Eisenhower Fellowships; Author, "A Rating Agency's Perspective on Regulatory Reform," book chapter published by Public Utilities Reports, Summer 1995; Advisory Committee, Public Utilities Fortnightly.

March 1994 – April 2002

Consultant -- NYNEX -- New York, Ameritech -- Chicago, Weatherwise USA -- Pittsburgh

Provided testimony before the Federal Communications Commission and state public utility commissions; Formulated and taught specialized ethics and negotiation skills training program for employees in positions of a sensitive nature due to responsibilities involving interface with government officials, marketing, sales or purchasing; Developed amendments to NYNEX Code of Business Conduct.

October 1987 - October 1993

Chairman; Commissioner -- Michigan Public Service Commission -- Lansing

Administrator of \$15-million agency responsible for regulating Michigan's public utilities, telecommunications services, and intrastate trucking, and establishing an effective state energy policy; Appointed by Democratic Governor James Blanchard; Promoted to Chairman by Republican Governor John Engler (1991) and reappointed (1993).

Initiated case-handling guideline that eliminated agency backlog for first time in 23 years while reorganizing to downsize agency from 240 employees to 205 and eliminate top tier of management; MPSC received national recognition for fashioning incentive plans in all regulated industries based on performance, service quality, and infrastructure improvement.

Closely involved in formulation and passage of regulatory reform law (Michigan Telecommunications Act of 1991) that has served as a model for other states; rejuvenated dormant twelve-year effort and successfully lobbied the Michigan Legislature to exempt the Commission from the Open Meetings Act, a controversial step that shifted power from the career staff to the three commissioners.

Elected Chairman of the Board of the National Regulatory Research Institute (at Ohio State University); Adjunct Professor of Legislation, American University's Washington College of Law and Thomas M. Cooley Law School; Member of NARUC Executive, Gas, and International Relations Committees, Steering Committee of U.S. Environmental Protection Agency/State of Michigan Relative Risk Analysis Project, and Federal Energy Regulatory Commission Task Force on Natural Gas Deliverability; Eisenhower Exchange Fellow to Japan and NARUC Fellow to the Kennedy School of Government; Ethics Lecturer for NARUC.

August 1985 - October 1987

Acting Associate Deputy Under Secretary of Labor; Executive Assistant to the Deputy Under Secretary -- U.S. Department of Labor -- Washington DC

Member of three-person management team directing the activities of 60-employee agency responsible for promoting use of labor-management cooperation programs. Supervised a legal team in a study of the effects of U.S. labor laws on labor-management cooperation that has received national recognition and been frequently cited in law reviews (U.S. Labor Law and the Future of Labor-Management Cooperation, w/S. Schlossberg, 1986).

January 1983 - August 1985

Senate Majority General Counsel; Chief Republican Counsel -- Michigan Senate -- Lansing

Legal Advisor to the Majority Republican Caucus and Secretary of the Senate; Created and directed 7-employee Office of Majority General Counsel; Counsel, Senate Rules and Ethics Committees; Appointed to the Michigan Criminal Justice Commission, Ann Arbor Human Rights Commission and Washtenaw County Consumer Mediation Committee.

March 1982 - January 1983

Assistant Legal Counsel -- Michigan Governor William Milliken -- Lansing

Legal and Labor Advisor (member of collective bargaining team); Director, Extradition and Clemency; Appointed to Michigan Supreme Court Sentencing Guidelines Committee, Prison Overcrowding Project, Coordination of Law Enforcement Services Task Force.

October 1979 - March 1982

Appellate Litigation Attorney -- National Labor Relations Board -- Washington DC

Other Significant Speeches and Publications

Filing for Bankruptcy Isn't the Right Solution for Puerto Rico (Forbes Online, November 2015)

The "A" Rating (Edison Electric Institute Perspectives, May/June 2009)

Perspective: Don't Fence Me Out (Public Utilities Fortnightly, October 2004)

Climate Change and the Electric Power Sector: What Role for the Global Financial Community (during Fourth Session of UN Framework Convention on Climate Change Conference of Parties, Buenos Aires, Argentina, November 3, 1998) (unpublished)

Regulation UnFettered: The Fray By the Bay, Revisited (National Regulatory Research Institute Quarterly Bulletin, December 1997)

The Feds Can Lead...By Getting Out of the Way (Public Utilities Fortnightly, June 1, 1996)

Ethical Considerations Within Utility Regulation, w/M. Cummins (National Regulatory Research Institute Quarterly Bulletin, December 1993)

Legal Challenges to Employee Participation Programs (American Bar Association, Atlanta, Georgia, August 1991) (unpublished)

Proprietary Information, Confidentiality, and Regulation's Continuing Information Needs: A State Commissioner's Perspective (Washington Legal Foundation, July 1990)